

**Attachment to SR Letter on
Enhancements to the Interagency Program for
Supervising U.S. Operations of FBOs**

GUIDELINES FOR THE FBO SUPERVISION PROGRAM

I. FBO SUPERVISION PROGRAM PROCEDURES

The attached guidelines provide specific requirements for the content and timing for some of the FBO Supervision Program products, including modified or additional procedures resulting from the implementation of the FBO Desktop, and additional document types resident in the FBO Desktop. The guidelines provide basic formats for the products and a glossary of FBO Program terms. These formats are intended to ensure that all necessary components are covered and a minimum level of business process uniformity is achieved among the U.S. supervisory agencies. However, it is expected that each participant in the FBO Supervision Program will use judgment in deciding which elements of any process should be emphasized in relation to the circumstances surrounding each FBO, its U.S. operations and its home country banking environment.

Application of FBO Supervisory Program Procedures

Procedural requirements for the FBO Supervision Program apply to all FBOs with a direct banking presence in the United States, through branches or agencies, Edge or agreement corporations, commercial lending companies or subsidiary banks. While parent companies of these FBOs also are considered to be FBOs, these products will not necessarily be developed for these higher-tier companies unless they also have a direct U.S. banking presence. Instead, if the strength or weakness of a parent organization bears on the condition of the U.S. banking operations, these situations are to be addressed through the supervision of the FBO with the direct U.S. banking presence.

Additionally, for examination planning purposes, if a U.S. nonbank company is an affiliate (not a subsidiary) of an FBO with a direct banking presence in the United States by virtue of being a subsidiary of a higher-tier company within the organization, examination planning for the nonbank entity, if necessary, should be addressed within the risk-focused examination planning process for the affiliated FBO with the direct U.S. banking presence (or the most appropriate FBO in organizations with multiple foreign banks with a direct U.S. presence).

This is illustrated by the following example whereby (A) "FBO Top" owns "FBO Direct"; (B) FBO Direct has a U.S. branch; and (C) FBO Top owns a consumer finance company in the United States. In this instance, if it were decided that the consumer finance company should be examined, the examination planning for this company would be addressed in the examination planning process for that of FBO Direct. There is no comprehensive risk-focused supervision plan prepared for FBO Top, as this top-tier company has no direct U.S. banking presence.

Usage of the FBO Desktop

Once a Reserve Bank or other agency has implemented the FBO Desktop, most forms of paper communications, including all FBO Supervision Program products, are to be distributed as electronic versions of documents through the FBO Desktop. As additional Reserve Banks and other banking agencies install the FBO Desktop, the FBO Desktop Project Manager will notify all FBO Supervision Program participants.

Reserve Banks and other banking agencies that have not implemented the FBO Desktop System should continue to distribute, receive and comment on FBO Program products by regular mail or Federal Reserve System pouch. It is anticipated that each Reserve Bank participating in the FBO Supervision Program will have access to the FBO Desktop in 1998. State and federal banking agencies participating in the FBO Supervision Program are reviewing their plans for having access to the FBO Desktop.

Distribution

The Reserve Bank or other agency with responsibility for performing an FBO Supervision Program process for a particular country or FBO will distribute the end products of its work to all parties involved in the supervision of the U.S. operations of FBOs that are headquartered in the foreign country. These nine products include:

1. Review of the Home Country Financial System
2. Review of Home Country Accounting Practices
3. Strength of Support Assessments (SOSA)
4. Risk Matrix (Optional distribution to other parties)
5. Risk Assessment
6. Supervisory Plan
7. Examination Program
8. Scope Memorandum
9. Summary of Condition and Assignment of Combined Rating

A copy of each of these nine products should be provided, via the FBO Desktop or other distribution methods, to the following parties:

- State supervisor responsible for a banking office (not defined as including a representative office or nonbank subsidiary) of an FBO from the country.

- The OCC if an FBO from the country has a federally licensed entity.
- The FDIC if an FBO from the country has an insured entity.
- Each Reserve Bank in which an FBO from that country has a banking presence in the district.
- Board staff in the FBO Supervision Section.

Further, a copy of the Summary of Condition and Assignment of Combined Rating should be sent to the Chief Executive Officer at the head office of the FBO, as well as a copy to the U.S. regional office of the FBO, and, if appropriate, a copy to the Home Country Supervisor.

Time Guidelines/Comment Period

Time guidelines described in SR 96-20 relating to the comment period and distribution of final products under the FBO Supervision Program have been modified for the following FBO Supervision Program products: SOSAs, the Home Country Financial System Review (not including the Accounting Policy and Practices), and the Summary of Condition and Assignment of Combined U.S. Rating. Time guidelines and comment periods are rescinded for the following FBO Supervision Program products: Review of Home Country Accounting Practices, and risk-focused supervisory products that replace the Comprehensive Examination Plan (please refer to the chart in the guidelines under Section V).

The draft and comment process for FBO Program documents without a specified comment deadline remains optional, at the discretion of the authoring Reserve Bank or other agency. Where comments are optional, Reserve Banks and other agencies may specify a comment deadline on the first page of the FBO Supervision Program document.

Since several FBO Supervision Program processes continue to depend upon timely comment from the various U.S. banking supervisory agencies, these guidelines set forth time periods allotted for receiving comments from staff at the Board, other Reserve Banks, and the other federal and state agencies. Reserve Banks should assume that parties not providing comments within the time allotted are in agreement with the draft FBO product.

Exceptions to or Extensions of Required Due Dates

Each Reserve Bank should notify Board staff in advance of any anticipated deviations from the FBO Supervision Program procedures contained herein. In addition, any delays in meeting pre-determined deadlines should be communicated via the FBO Desktop to the Board supervision analyst assigned to the country or FBO for which the delay will occur. The communication should include a brief explanation for the delay and the anticipated date of completion.

“Compound” Documents within the FBO Supervision Desktop

Frequently, certain statistical information is required to support SOSAs, Reviews of Home Country Financial Systems, or other FBO Program analyses. This supporting information typically takes the form of spreadsheet tables or charts. It is desirable that this information be incorporated within a single FBO Supervision Program document. However, because the size and complexity of the supporting information may vary, it may not be feasible to include statistical data within a single document (e.g., a SOSA provided in a word processing document and peer group financial data presented in a spreadsheet format). As a result, a file attachment is needed to provide such information. If file attachments are used to provide supporting information, these files should be attached to the FBO Program document as a “Comment” entered in the Lotus Notes component of the FBO Desktop. The title of the comment should describe the contents of the attachment. The base FBO Program document will continue to be loaded into the FBO Desktop utilizing the DOCS Open component of the FBO Desktop system.

Additional FBO Supervision Program Related Documents

Features of the FBO Desktop have been enhanced to facilitate the sharing of other categories of documents, including briefing materials, other memoranda, trip reports, and enforcement actions. All available information that falls into these four categories can be entered into the FBO Desktop starting on June 1, 1998. Further, all outstanding enforcement actions, either formal or informal, must be entered into the FBO Desktop by September 30, 1998.

II. REVIEW OF THE HOME COUNTRY FINANCIAL SYSTEM

Description

A review of the financial system of each country with bank representation in the United States should be prepared and consist of a description of the structure of the financial system, the process of supervision and regulation, and the treatment of problem or failed institutions. In addition, the review should include a summary of the current condition and operating performance of the country’s financial system. (Refer to outline in Appendix I). The financial system reviews are intended for U.S. supervisory use only and, as such, these reviews should be treated as Restricted documents.

Time Guidelines/Comment Period

With the completion of the initial home country financial system reviews, the reviews should be examined at least annually to determine whether there is a need for revision and issuance of an updated review, or if the existing document can be reaffirmed without the need for issuing an update. An updated review or a message indicating that no changes are needed must be transmitted via the FBO Desktop at least every twelve months.

In the event that an updated review needs to be issued, each party will have 12 calendar days to review the draft revisions and provide comments, prior to distribution of the final product.

Re-issue of Comprehensive Reviews

These guidelines notwithstanding, a comprehensive re-issue of the home country financial system review must be prepared when significant changes in a country's bank supervision system occur or when there is a perceived alteration in the risk profile of the financial system. As an example, a country subjected to a severe economic crisis, the result of which in part is the reformation of its bank supervision system, should be subject to a comprehensive re-analysis of its financial system. Reserve Banks have discretion in the presentation of the document. However, in that significant changes occur in a country's financial system, it should be noted that a standard annual update would be insufficient.

III. REVIEW OF HOME COUNTRY ACCOUNTING PRACTICES

Description

For each country with banking representation in the United States, a review of the country's significant accounting policies and practices for banking organizations has been developed to highlight those accounting policies and practices that differ significantly from U.S. GAAP. The studies cover the following areas: (1) asset valuation; (2) income and expense items; (3) consolidation rules; (4) off- versus on- balance sheet items; (5) tax considerations; and (6) disclosure rules (refer to the outline in Appendix II).

Time Guidelines/Comment Period

These documents should be updated as necessary to reflect important changes in accounting policies and practices in a particular country. The accounting reviews are intended for U.S. supervisory use only and, as such, should be treated as Restricted documents. There is no comment period for revisions or amendments to this product.

IV. STRENGTH OF SUPPORT ASSESSMENT

Description

The FBO's annual strength of support assessment (SOSA) is divided into two components: (1) analysis of available information on the financial and operational condition of the FBO within the context of the home country financial system, and (2) significant accounting

policies and practices reviews. In this regard, the demonstrated abilities of the home country to deal with banking problems, as well as the degree of transfer risk associated with the FBO's home country and any other countries in which it has major operations, are factors that merit strong consideration in the SOSA development process. The analysis is to be updated during the course of the year as information becomes available that is significant enough to change the SOSA for a particular FBO. Again, the SOSA should draw upon the analyses developed in the Review of the Home Country Financial System and the Review of Home Country Accounting Practices.

The Reserve Bank or other bank supervisory agency responsible for drafting the SOSA should exercise some discretion in deciding the information to include in the analysis based on the individual circumstances of the FBO. The analysis normally should contain the following analytical considerations: (1) financial factors; (2) prospects and key risks; (3) home country support; (4) other assessment factors; and (5) supervisory implications of the assessment (refer to the outline in Appendix III). Supervisory implications derived from the SOSA are of particular importance, and should provide a benchmark for developing the supervisory strategy under the risk-focused supervision framework. All SOSAs and supporting analyses are Restricted and for U.S. supervisory use only and should not be disclosed to the U.S. or head office management of the FBO or to its home country supervisor(s).

Recommendations on the supervision strategy for the U.S. operations of a FBO arising from the SOSA are to be presented in the supervisory implications section (section VII) of the analysis. (Refer to Appendix III.) These recommendations should be in accordance with the assigned SOSA, as outlined in SR 95-22. In cases where a SOSA of "C" or worse is assigned or when there are questions about the ability of the FBO to maintain adequate risk management processes, internal controls, or compliance procedures at its U.S. offices, the supervisory implications section must reflect a robust supervisory action plan that addresses the concerns with the FBO as they relate to its U.S. operations. This would serve as a building block in preparing the Supervisory Plan and the Examination Program for an FBO's U.S. operations (section IV). An asterisk should be used to identify concerns or questions about the organization's risk management processes, internal controls, and compliance procedures.

Significant homogeneity exists in the assessment factors for FBOs from certain countries. Reserve Banks may determine, in certain cases, that peer group analyses of assessment factors among like FBOs is best accomplished through one document that compares and contrasts the strengths and weaknesses, similarities, and unique characteristics of peer groups of FBOs within a country. As such, a single document may represent the SOSA analysis for a number of FBOs from the same country. In these instances, a SOSA ranking must be assigned to each FBO, and the assessment factors still must be considered for each FBO in the peer group analysis. The Reserve Bank or other agency also must input the single document into the FBO Desktop for each FBO subject to the peer analysis.

Time Guidelines/Comment Period

The timing of each FBO's annual SOSA analysis and grading will be based primarily on the fiscal year-end of the FBO and subsequent receipt date of its FR Y-7 report, the extent and overall condition of the FBO's U.S. operations, and the prior year's assessment of the FBO. As with the Home Country Financial System Review, each party will have the opportunity to provide comments to the draft, prior to the distribution of the final document.

Upon distribution of a draft SOSA analysis, each party will have 12 calendar days to provide comments. Reserve Banks will have up to an additional 15 calendar days following this comment period to provide a revised draft SOSA and supporting analysis. (It is assumed that at this stage of the process the Board FBO Supervision Program staff will have concurred with the content of the SOSA and the FBO's assigned SOSA ranking.) Reserve Banks should not distribute final-status SOSAs until receiving notification of concurrence from the responsible SOSA analyst at the Board, who will communicate Board staff sign-off as a comment via the FBO Desktop after consultation with the appropriate BS&R Division management.

V. RISK-FOCUSED FRAMEWORK FOR SUPERVISION OF FBOs

Description

The risk-focused framework for the supervision of FBOs is intended to provide a coordinated, thorough and efficient approach for supervising the U.S. operations of FBOs that conduct their business in the United States through multiple operating entities. As such, all operations of an FBO located in the United States, including bank holding companies and commercial banks, should be considered in establishing the risk-focused supervision program. Within this program, bank holding companies and commercial banks owned or controlled by an FBO should be subject to an individual analysis in accordance with the Framework for Risk-Focused Supervision of Large Complex Institutions (SR 97-24) or the companion guidance for Risk-Focused Supervision of Community Institutions (SR 97-25). (Commercial banks supervised by another federal bank supervisory agency would be subject to the risk-focused products adopted by that agency.)

The products developed for FBO-owned or -controlled bank holding companies and commercial banks under the risk-focused program for Large Complex Institutions or Community Institutions should be included as identified items in the products developed for the FBO's U.S. operations so that, in effect, there will be a complete set of documents for an FBO's entire U.S. operations on a combined basis. For example, a risk assessment for an FBO that operates (1) a bank holding company, (2) several branches and agencies, and (3) a directly-owned Edge corporation, should include a risk assessment of the FBO's combined U.S. operations and, within the same document, provide a separate risk assessment for the bank holding company.

In order to provide for the most effective utilization of supervisory resources, it is important that the risk-focused planning process be treated as continually evolving, to the extent possible, throughout the year. Further, the on-site and off-site review strategies developed for the U.S. operations of each FBO should remain flexible to incorporate changes in financial and other relevant factors as warranted.

To align the FBO Supervision Program with the Risk-Focused Framework for the Supervision of Large Complex Institutions, Reserve Banks are being requested to implement the guidance provided in SR 97-24 and its companion handbook, which provides a description and examples of the supervisory products. In accordance with the instructions found on page 13 of that handbook, Reserve Banks are now required to follow a highly defined process for supervisory planning. In effect, the Comprehensive Examination Plan and the Individual Examination Plan, as described in the original issuance of the FBO Supervision Program, will no longer be utilized. To replace these products, responsible Reserve Banks should prepare a Risk Matrix and Risk Assessment, Supervisory Plan, Examination Program, and Scope Memorandum as described in the handbook. To replace the Individual Examination Plan, local banking supervisory agencies, in consultation with the responsible Reserve Bank, should prepare a Risk Matrix, Risk Assessment, Supervisory Plan, and Scope Memorandum for the local entities, as appropriate.

All FBOs included in the Global Supervision Program will be supervised utilizing the full complement of products comprising the large complex institutions supervision framework. In general, Reserve Banks also should utilize the full complement of products for FBOs with multi-state operations. For FBOs operating a single office or operating in only one state, Reserve Banks may combine the Risk Matrix, Risk Assessment, Supervisory Plan, Examination Program, and Scope Memorandum into fewer documents, to reflect the reality of a less complex U.S. operation. The recommended approach for these “non-complex” banking organizations is to prepare only a Risk Assessment, Supervisory Plan and Scope Memorandum, rather than a full array of products. Similarly, for FBOs with multi-state operations where the offices outside the home state are very limited, it may be feasible to combine products.

Time Guidelines/Comment Period

All products prepared by the responsible Reserve Bank or other bank supervisory agency in the supervisory planning process (i.e., documents 2 through 5 in the Risk-Focused FBO Supervisory Process) should be entered into the FBO Desktop as final documents, as they are not subject to formal comment. The columns in the following matrix illustrate 1) the FBO Supervision Framework as described in SR 95-22 and SR 96-20, 2) the steps in the risk-focused supervisory process for large complex institutions as described in SR 97-24, and 3) the present risk-focused FBO supervisory process.

FBO Supervision Framework As described in SR 95-22 and SR 96-20	Large Complex Institution Framework Steps As described in SR 97-24	Risk-Focused FBO Supervisory Process
1. Strength of Support Assessment (SOSA) \1	A) Understanding the Institution	1. Strength of Support Assessment (SOSA) \1 \2
2. Comprehensive Examination Plan \3	B) Assessing the Institution's Risk	2. Risk Matrix Risk Assessment
2. Comprehensive Examination Plan \3	C) Planning and Scheduling Supervisory Activities	3. Supervisory Plan Examination Program
2. Comprehensive Examination Plan \3	D) Defining Examination Programs	4. Scope Memorandum Entry Letter
3. Examination Reports 4. Summary of Condition and Assignment of Combined U.S. Operations' Rating	E) Reporting the Findings	5. Examination Findings, Recommendations and Conclusions 6. Summary of Condition and Assignment of Combined U.S. Operations' Rating

\1 Incorporates analysis from the Review of the Home Country Financial System and the Review of Significant Home Country Accounting Policies and Practices.

\2 Replaces the Institutional Overview.

\3 Comprehensive Examination Plan is rescinded.

VI. SUMMARY OF CONDITION AND ASSIGNMENT OF A COMBINED RATING

Description

At a minimum, following the conclusion of the last examination of an FBO's U.S. operations in a given annual supervisory cycle, a Summary of Condition should be prepared for all FBOs with multiple U.S. operations. (Refer to Appendix IV for guidelines on preparing the Summary of Condition. Please note that for FBOs whose U.S. operations include a commercial bank supervised directly by the OCC or the FDIC, the Reserve Bank drafting the Summary of Condition should include appropriate language in the document identifying the primary supervisory agency for the bank, and that agency's appropriate contact person.) The responsible Reserve Bank, or other U.S. bank supervisory agency, should prepare an evaluation of the condition of the FBO's U.S. operations, which will lead to the assignment of a single-component rating between "1" and "5" for those operations on a combined basis.

This evaluation should include an assessment of all risk factors, focusing on the components of the ROCA rating system. The Summary of Condition and rating of the FBO's combined U.S. operations represent important tools that are to be utilized in reaching decisions regarding the scope and frequency of future examinations and appropriate supervisory measures. This information also should provide the basis for a more efficient utilization of supervisory resources (i.e., recognizing, where appropriate, a low or high risk of supervisory concern for the FBO's combined U.S. operations).

The Summary of Condition should be prepared as a letter to the FBO's head office management and highlight those areas of overall strength and any systemic weaknesses in the FBO's U.S. operations. (Refer to Appendix IV for a sample letter, which is modified from the letter contained in SR 96-20.) The Summary of Condition should not be treated as an examination report and, as such, should not contain highly sensitive, statutorily prohibited data obtained through the examination process. For example, in discussing asset quality, a concise assessment of the asset quality of the FBO's combined U.S. operations would suffice. However, individual credit risk exposures or a list of names of individual credits should not be provided.

Time Guidelines/Comment Period

The draft Summary of Condition and rating of the FBO's combined U.S. operations are to be distributed for comment within 60 calendar days following the date that the examiners conclude the on-site portion of the last review within the current round of examinations. Each U.S. banking supervisory agency will have 12 calendar days to review the draft document and provide comments. The Summary of Condition and rating are to be finalized within 15 calendar days from the conclusion of the comment period.

Distribution

Responsible Reserve Banks are required to inform the home country supervisor of any matters of supervisory significance that have been identified in the process of assessing the condition of the FBO's U.S. operations. The responsible Reserve Bank also should notify the home country supervisor that the Summary of Condition and the rating of the FBO's combined U.S. operations have been sent to its head office. In this connection, the responsible Reserve Bank should send a copy of the final version of the Summary of Condition and Assignment of Combined U.S. Operations' Rating to the FBO's home country supervisor.

Due to statutory considerations, and the Board's rules relating to the transfer of confidential supervisory information, Reserve Banks are authorized to use only the form transmittal letter attached as Appendix IV-A. Reserve Banks may not amend the letter without explicit approval of the Board's Legal Division and Division of Banking Supervision and Regulation. The transmittal letter to the FBO's home country supervisor should be posted to the FBO Desktop within the Summary of Condition and combined rating.

It is important that the final version of the Summary of Condition and combined rating should not be transmitted before distribution of all individual examination reports to all entities supervised by U.S. bank regulatory authorities.

VII. FBO SUPERVISION PROGRAM RELATED DOCUMENTS

Phase I of the FBO Desktop concentrated on the development of a medium that would facilitate exchange of information in preparation of FBO supervisory products. This remains an important goal of the FBO Desktop, especially with the introduction of additional products aimed at enhancing the examination planning process and ensuring that it is risk-focused. Moreover, the FBO Desktop can be utilized for the exchange of other documents that are valuable in the supervisory process, and enhancements have been added to the FBO Desktop to accept several other categories of documents. The categories include: (1) briefing material, (2) other memoranda, (3) trip reports, and (4) enforcement actions.

It is envisioned that the enhanced distribution of these categories of information through the FBO Desktop should further improve the efficiency and effectiveness of the FBO Supervision Program. Guidance regarding the distribution of the new FBO Supervision Program related documents is provided below.

Time Guidelines/Comment Period

In contrast to the distribution procedure for FBO Supervision Program documents (e.g., SOSA, Review of the Home Country Financial System, and Summary of Condition) in draft version for comment, these added FBO Supervision Program related documents should only be distributed on the FBO Desktop as “Final.” As such, FBO Desktop participants should not provide comments on the following documents.

Briefing Material

The Reserve Banks, Board, and other federal and state banking agencies devote significant resources to the composition of timely, comprehensive briefing material. The development of briefing documents often relates to matters of supervisory concern prompted by rapidly changing conditions in foreign country economies and financial systems. FBO Supervision Program participants are encouraged to utilize this added topic as another method to enhance the sharing of information and collaboration in the supervision of FBOs’ U.S. operations.

Other Memoranda

The “Other Memoranda” category describes informational materials pertaining to important supervisory documents that do not fit the criteria established for other FBO Supervision Program related documents. For example, after important discussions among Reserve Banks or other agency staff take place with FBO management or FBO home country supervisory authorities, staff prepares a memorandum to document the meeting. Summary memoranda regarding these discussions are highly valuable and should be shared via the FBO Desktop.

Trip Reports

Meetings with home country supervisors and head office operations of FBOs provide valuable intelligence on the condition of an FBO and its home country banking environment. As a rule, the Reserve Bank, Board, or other agency staff person who takes a trip to foreign banking jurisdictions will prepare a trip report summarizing the meetings conducted. Distribution of this information on the FBO Desktop provides a secure and readily accessible location to share this information in support of FBO supervision in the United States.

Enforcement Actions

An information category is available for Reserve Banks and other agencies to distribute both formal and informal enforcement actions through the FBO Desktop. Only enforcement actions that are final and have been executed by the institution or institution-affiliated party should be entered in the FBO Desktop. Reserve Banks or other bank supervisory agencies executing the enforcement action are responsible for entering the document in the FBO Desktop. Summaries of progress reports relative to these actions also should be entered as a Lotus Notes comment to the enforcement action document so that the most currently available information is readily accessible. In general, enforcement actions should be placed in the desktop within 30 days of execution.

LISTING OF APPENDICES

- I. HOME COUNTRY FINANCIAL SYSTEM REVIEW
- II. REVIEW OF HOME COUNTRY ACCOUNTING PRACTICES
- III. STRENGTH-OF-SUPPORT ASSESSMENT FOR A FOREIGN BANKING ORGANIZATION
- IV. SUMMARY OF CONDITION LETTER GUIDELINES
 - IV-A. TRANSMITTAL LETTER TO HOME COUNTRY SUPERVISOR
- V. FBO GLOSSARY

Note: Samples of the products for risk-focused supervisory process are included in the handbook on “Framework for Risk-Focused Supervision of Large Complex Institutions” which is attached to SR 97-24.

Appendix I

OUTLINE FOR THE REVIEW OF THE HOME COUNTRY FINANCIAL SYSTEM

Country _____
As of Date¹ _____
Contact Name _____

Draft _____ Final _____
FRB _____
Phone _____

- I. Structure of the Financial System
 - A. Types of institutions
 - 1. Permissible activities/investments
 - 2. Ownership restrictions
 - B. Concentration of the banking market
 - C. Existence of financial conglomerates
 - D. National treatment/presence of foreign banks
- II. Current Condition and Operating Performance of the Financial System
- III. Supervision and Regulation
 - A. Key banking law(s)
 - B. Agencies involved in banking supervision
 - C. Supervisory techniques
 - 1. Chartering criteria
 - 2. Prudential rules (including an in-depth discussion of capital requirements and permissible capital components)
 - 3. Examinations vs. reliance on external auditors
 - 4. Reporting requirements/off-site surveillance
 - 5. Corrective measures/sanctions
 - 6. Powers of intervention
 - D. Extent to which supervisor assesses the consolidated worldwide operations
- IV. Treatment of Problem/Failed Institutions
 - A. History of government support of individual banking institutions
 - B. Lender of last resort
 - C. Deposit insurance program
 - D. Bankruptcy laws
 - E. Other legal issues

¹ The As-of Date reflects the date of the report.

Appendix II

OUTLINE FOR THE REVIEW OF HOME COUNTRY ACCOUNTING PRACTICES

Country _____
As-of Date² _____
Contact Name _____

Draft _____ Final _____
FRB _____
Phone _____

- I. Asset Valuation
 - A. Nonperforming definition/accrual practices
 - B. Provisioning policies
 - C. Charge-off policies
 - D. Revaluation reserves
 - 1. Fixed assets
 - 2. Securities portfolio
 - E. Undisclosed reserves
 - F. Inflation accounting/monetary correction
 - G. Intangibles/goodwill
 - H. Accounting for subsidiaries and affiliates
- II. Income and Expense Items
 - A. Provisioning Policies
 - B. Accrual Methods
 - C. Inflation accounting/monetary correction
- III. Consolidation Rules
 - A. Accounting for subsidiaries and affiliates
 - B. Accounting for intercompany transactions
- IV. Off- versus On-Balance Sheet
- V. Tax Considerations
- VI. Disclosure Rules
 - A. Adoption of internationally accepted accounting standards
 - B. Financial reporting requirements

² The As-of Date reflects the date of the report.

Appendix III

STRENGTH-OF-SUPPORT ASSESSMENT FOR A FOREIGN BANKING ORGANIZATION

FBO Name	_____	Draft	____	Revised Draft	____	Final	____
Country	_____	FRB	_____				
RSSD ID	_____	As-of Date ³	_____				
Contact Name	_____	Phone	_____				

I. Executive Summary

The executive summary should provide a brief synopsis of the findings of the annual FBO evaluation and state the SOSA assigned to the FBO. The executive summary should, in effect, provide a brief justification for both the letter assessment and, where necessary, the use of the asterisk. In addition, any implications for the supervision of the U.S. operations of the FBO based on the assessment should be summarized in this section.

- A. Assessment with brief justification for both components
- B. Implications for supervision of U.S. operations

II. Overview of the FBO

The overview section of the FBO evaluation should provide background information on the FBO. Information contained in this section should not necessarily change substantially from year to year. The overview should describe, among other things, the types of activities in which the FBO is engaged, its market share, ownership, and a brief summary of its U.S. operations.

- A. Description of the FBO (including type of charter)
- B. Market share
- C. Ownership
- D. Key subsidiaries/activities/off-balance sheet
- E. Major business lines - including any major changes in strategic focus
- F. Summary of U.S. operations

III. Financial Factors

The annual review of the FBO's financial factors, together with an analysis of the Home Country Financial System, should serve as the foundation for the assessment of the condition and outlook of the FBO. This assessment should be based on the level and trend in financial performance indicators relating to capital, profitability, asset quality, liquidity, and,

³ The As-of Date reflects the date of the balance sheet data used to evaluate the financial condition of the FBO.

where appropriate, other financial risk factors. These indicators should be evaluated in the context of home country peer performance and knowledge of the FBO's home country financial system and accounting policies and practices.

- A. Capital
- B. Profitability
- C. Asset quality
- D. Liquidity
- E. Other financial risk factors (including off-balance sheet items, derivatives, and trading activities)

IV. Prospects

This section should concentrate on where the organization is going, rather than where it has been. This is the appropriate section to incorporate any significant trends in the financial sector in the FBO's home country which might impact the FBO's major lines of business or any radical shifts in strategic focus by the FBO.

V. Home Country Support

As part of the evaluation of the financial profile of an individual FBO, it is important to review the factors related to the individual FBO that would suggest a certain level of support by the home country if the FBO were to experience serious difficulties. This should include the size of the FBO and its overall significance to the home country financial system, the ownership of the FBO, and the record of past support provided to the FBO or other banks in the home country of a similar size or significance.

VI. Assessment of whether factors are present that might lead to more than usual operational or compliance risks for U.S. offices

This section should assess whether any factors are present that might lead to more than normal operational or regulatory compliance risks for U.S. offices. This includes factors such as recent large mergers by the FBO with other organizations, rapid expansion into new types of business or geographic areas, or publicized nonfinancial problems encountered in the FBO's domestic or global operations. These factors, although not having an immediate impact on the overall financial profile of the FBO, serve as indicators that existing or potential weaknesses unrelated to the FBO's ability to meet its financial obligations need to be considered when assessing the U.S. operations. Any concerns of this nature should be fully discussed in this section and highlighted by placing an asterisk beside the FBO's risk assessment.

VII. Implications for the supervision of the U.S. operations of the FBO based on the assessment

Any recommended changes to the strategy for supervising the U.S. operations of the FBO which arise from the SOSA analysis are to be presented in this section. These recommendations should be appropriate to the assigned SOSA, as outlined in pages 7 and 8 of Attachment II to SR Letter 95-22.

In cases when a SOSA of “C or worse” is assigned -- or whenever an asterisk is used to identify the presence of factors that raise questions about the ability of the FBO to maintain adequate internal controls and compliance procedures at its U.S. offices -- this section must either present recommended actions, or provide reasons as to why no additional actions are necessary at this time to enhance the monitoring and supervision of the U.S. offices.

Appendix IV

SUMMARY OF CONDITION LETTER GUIDELINES

ADDRESSEE

Appropriate Head Office Management of the FBO

SCOPE

Suggested Text:

This letter summarizes the Federal Reserve System's Assessment of the Combined U.S. Operations of XXX Bank. The evaluation was prepared by the Federal Reserve Bank of XXX (FRBXX), using the most recent reports of examination and inspection of your bank's U.S. units, which were conducted as of (coordinated as of date), updated with available financial information to (appropriate later date). A copy of this letter also has been sent to XXX Bank's regional management in (regional headquarters location).

The scope of our review included all banking and nonbanking activities of XXX in the U.S., and focused on risk management, operations, compliance, and asset quality. This involved reviewing reports of examination and inspection of every U.S. unit of XXX; conducting any necessary financial and regulatory analysis; and holding discussions about the condition of XXX's U.S. operations with other Federal regulatory agencies and Reserve Banks, State Banking Departments, and with staff of the Board of Governors.

OVERALL CONDITION

Indicate overall condition, referencing overall evaluations of risk management, operations, compliance, and asset quality. Cite composite ratings of individual units if appropriate. Identify weaknesses in critical areas (see below for individual headings). State whether these weaknesses are considered correctable in the normal course of business, and if not, cite specific results required to resume satisfactory operations. Conclude with qualitative evaluation of overall operations.

Trading Risk Management

Credit Risk Management

Operations and Audit

Compliance

Asset Quality

Other Matters

Discuss other matters relating to non-ROCA component ratings of insured banks or nonbanks.

COMBINED U.S. RATING

Suggested Text:

As noted earlier, we consider U.S. operations to be (qualitative evaluation). Specifically, we have accorded a rating of "(numeric rating)" to XXX's combined U.S. operations. In general, a "(numeric rating)" rating is assigned when... (See SR letter 95-22 for proper definition of 1-5 evaluations)

CORRECTIVE ACTIONS

Describe action taken to date to address weaknesses outlined earlier in the assessment. Acknowledge, where appropriate, any other previous contact, i.e., meetings, conference calls or correspondence, in which these overall findings and corrective action may have been discussed.

OUTSTANDING U.S. SUPERVISORY ACTION

For existing actions, discuss any areas of partial or noncompliance, and related remedial action.

DISCLOSURE

Suggested Text:

Please note that this evaluation is part of the overall findings of U.S. regulatory examinations. The contents of this letter are subject to the rules of the Board of Governors of the Federal Reserve System regarding disclosure of confidential supervisory information. Under no circumstances shall the bank, or any of its directors, officers, or employees disclose or make public in any manner this letter or the combined U.S. rating. Please direct any questions or comments to (Portfolio Manager or Team Leader) at (XXX) XXX-XXXX.

Very truly yours,

Senior Officer for BS&R

cc: Regional U.S. FBO management
BOG Staff

SAMPLE SUMMARY OF CONDITION LETTER

Date

Mr. John Doe
Senior Managing Director
The FBO Bank

Dear Mr. Doe:

This letter summarizes the U.S. banking supervisory agencies' assessment of the condition of the Combined U.S. Operations of The [FBO] Bank ("FBO"). The evaluation was prepared by the Federal Reserve Bank using the most recent reports of examination and inspection of FBO's U.S. units, the majority of which were conducted as of June 30, 1994, updated with available financial information to December 31, 1994. A copy of this letter has been sent to [name, title] of the Americas Division in New York, and to [name, title] of [home country supervisory authority].

The scope of our review included all banking and nonbanking activities of FBO in the United States, and focused on risk management, operations, compliance, and asset quality. This involved reviewing reports of examination and inspection of every U.S. unit of FBO; conducting any necessary financial and regulatory analysis; and holding discussions about the condition of FBO's U.S. operations with the State Banking Departments, [with the Comptroller of the Currency and/or the Federal Deposit Insurance Corporation, if applicable], with other Reserve Banks, and with staff of the Board of Governors.

The results of the review indicated that operations, compliance, and asset quality in the U.S. are generally satisfactory; indeed, the composite ratings of most units were satisfactory or strong as of their most recent examinations. However, systemic weaknesses were identified in the critical areas of risk management and internal audit. Because these deficiencies were detected in significant units, and because they could adversely affect safety and soundness, the U.S. banking supervisory agencies concluded that U.S. operations were less than satisfactory.

We reviewed our overall findings and conclusions with FBO's U.S. regional management at a meeting on April 26. Management was responsive and agreed to continue resolving all supervisory issues; and we know from prior and subsequent discussions with FBO, and a review of documents and correspondence, that FBO has already made a concerted effort to start addressing deficiencies. The remainder of this letter summarizes the deficiencies identified, defines our overall rating of U.S. operations, and discusses our plan to request a management commitment to continue corrective efforts.

TRADING RISK MANAGEMENT

Deficiencies were identified in trading risk management at both the Portland branch and the Miami agency. Issues at the Portland branch included management of the basis swaps portfolio, the management of U.S. Treasury notes, the violation of stop-loss limits, hedging, funding, and management of the interest rate exposure related to funding of securities. At the Miami agency, issues related to risk management included weaknesses in the Asset Liability Management Committee ("ALMC"); positions taken by the Treasury Department in conflict with the ALMC; non-adherence to the futures trading policy; and, a lack of independent stress testing. Management information systems were inadequate at both Portland and Miami.

CREDIT RISK MANAGEMENT

The credit risk management process needed to be strengthened at the Miami and New York agencies. At the Miami agency, the risk-grading process in the credit function was reliant on a single review officer who had recently resigned; none of the account officers adequately understood review standards or procedures. At the New York agency, significant exceptions in credit risk management were centered in credit analysis, documentation, repayment source analysis, and internal risk identification. These deficiencies affected adversely the examiners' evaluations of the ability of FBO management to monitor and manage credit risk at both units. Moreover, they could expose FBO to the risk of weakened asset quality in the future.

INTERNAL AUDIT

A review of the internal audit department at the Portland branch revealed weaknesses in the coverage of the Treasury Administration Department. Audit capabilities were limited and did not include a review of critical management reports or verification or review of the swaps portfolio pricing methodology. Audits failed to disclose breaches of stop-loss limits for certain deals as well as the entire swaps portfolio, and did not detect inaccuracies in the revaluation process which resulted in an overstatement of profits. Internal audit did not include any assessment of risk management of the basis swaps portfolio, and did not review basis swaps prior to implementation to ensure that proper operational and financial controls were in place. Finally, the internal audit department was seriously understaffed.

OTHER MATTERS

American Subsidiary Bank's ("ASB") financial performance was hampered by problem assets and high expenses at year-end 1994. At December 31, 1994, the bank's nonperforming loan ratio was 6.55 percent, approximately three times peer, while reserve coverage was only 41 percent. Moreover, ASB barely broke-even in 1994 because of large loan loss provisions coupled with high overhead costs. We understand that corrective efforts are in part focusing on reducing expenses and on improving asset quality. We would agree that this is important and would add that any necessary steps should be taken to ensure sustained improvement in critical processes so that past problems are not repeated.

COMBINED U.S. RATING

As noted earlier, we consider U.S. operations to be less than satisfactory. Specifically, we have accorded a rating of "3" to FBO's combined U.S. operations. In general, a "3" rating is assigned when overall U.S. operations are weak in risk management, operational controls, and compliance, or have numerous asset quality problems that in combination with the condition of the FBO cause supervisory concern. This rating may also be assigned when either risk management, operational controls, or compliance is individually viewed as unsatisfactory. In the case of FBO, issues center on deficiencies in risk management and controls. As a result, operations raise supervisory concern and require more than normal supervision to address their weaknesses.

CORRECTIVE ACTIONS

We note that FBO has already taken aggressive steps to correct deficiencies in each of the areas criticized, and is working toward an ambitious timetable. Verification of corrective action is normally part of the mandated examination process. However, this Reserve Bank may perform targeted on-site visitations to confirm progress at specific units. Notwithstanding, we would expect that the formal combined U.S. rating of "3" will remain in place until corrective action has been sustained and is effective in eliminating supervisory concerns.

U.S. SUPERVISORY ACTION

The Portland branch is now operating under a Commitment Letter ("Letter") dated February 13, 1995, issued jointly by the Federal Reserve Bank of Boston and the Maine State Banking Department. Under the terms of this Letter, management has agreed to resolve all trading deficiencies and other weaknesses noted in the examination report for this unit. Given that the composite evaluation reflected deficiencies in other units that should be addressed as discussed above, it would be helpful for FBO to provide this Reserve Bank with a written commitment, assuring that the bank will address and resolve all of the deficiencies noted. This is not intended to duplicate or supersede the Letter in place at the Portland branch; rather, the objective is to obtain a senior level management commitment to resolve all supervisory issues in FBO's U.S. network, while minimizing any additional regulatory burden. We will contact U.S. regional management in New York shortly regarding this matter.

APPLICATION FOR FBO SECURITIES (U.S.A.), Inc.

During our supervisory meeting with FBO on April 26, U.S. regional management stated that it would withdraw formally the application for "riskless principal" and private placement, made on behalf of FBO Securities (U.S.A.), Inc. We understand that withdrawal will take several weeks because of FBO's internal authorization process. Please ensure that FBO and/or its appointed representatives send any conclusive correspondence pertaining to the withdrawal to (the appropriate Applications officer) at this Reserve Bank.

Finally, please note that this evaluation is part of the overall findings of U.S. regulatory examinations. The contents of this letter are subject to the rules of the Board of Governors of the Federal Reserve System and other U.S. banking supervisory agencies regarding disclosure of confidential supervisory information. Under no circumstances shall the bank, or any of its directors, officers, or employees disclose or make public in any manner this letter or the combined U.S. rating. Please direct any questions or comments to Portfolio Manager Peter Jones at (415) 974-2000. [Note: include also contact names and telephone numbers for other U.S. banking supervisory agencies where a national or state nonmember commercial bank comprises part of the FBO's U.S. operations.]

Very truly yours,

Senior Official BS&R

Appendix IV-A

TRANSMITTAL LETTER TO FBO's HOME COUNTRY SUPERVISORY AGENCY

[HOME COUNTRY SUPERVISORY CONTACT]
[NAME OF SUPERVISORY AGENCY]
[ADDRESS]
[CITY, COUNTRY]

Dear:

The enclosed letter summarizes the Federal Reserve System's assessment of the combined U.S. operations of [Name of FBO], and was recently sent by this Reserve Bank to [Name of FBO]. This evaluation reflects the examination findings for the entities operated by [Name of FBO], which were examined during [year of examination, or as of examination date]. A listing of the entities examined also is enclosed. As a result of these examinations, [Name of FBO] was assigned a Combined U.S. Operations Rating of [numerical rating]. An institution whose U.S. operations are rated a [numerical rating] has [definition of the numerical rating].

Please take particular note of the following matters of supervisory significance:

[discuss briefly as necessary].

The Federal Reserve is providing you this supervisory information on a confidential basis. We are providing this information on the understanding that your agency will maintain the confidentiality of the information to the extent possible under applicable law, and that such information would be used only for lawful supervisory purposes.

For your information, we have informed [Name of FBO] that the contents of the letter summarizing the Federal Reserve System's assessment and the supervisory rating are subject to the rules of the Board of Governors of the Federal Reserve System regarding disclosure of confidential supervisory information, and that under no circumstances should the bank disclose or make public in any manner the attached letter or the combined U.S. rating.

Please direct any questions regarding the contents of this letter to [name of Reserve Bank Official, Title], at [phone number].

Sincerely,

[Name of Reserve Bank Official]
[Title]

Enclosures

Appendix V

GLOSSARY OF TERMS FOR FBO SUPERVISION PROGRAM

In order to assist in the uniform application of the FBO Supervision Program, this glossary of terms provides definitions for some of the most important topics relevant to FBO supervision. Additional information concerning terms that are central to the FBO Supervision Program can be found in Section 211.21 of Regulation K concerning International Banking Operations; SR 95-22, "Enhanced Framework for Supervising the U.S. Operations of Foreign Banking Organizations"; and the Examination Manual for U.S. Branches and Agencies of Foreign Banking Organizations.

Foreign Banking Organizations ("FBOs")

Procedural requirements for the FBO Supervision Program apply to all foreign banks with a direct banking presence in the United States, including: U.S. branches or agencies of foreign banks; Edge Act or agreement corporations; a commercial lending company subsidiary; or foreign banks that control a bank within the United States.

Review of Significant Home Country Accounting Policies and Practices

A review of the significant accounting policies and practices for financial institutions in each country with bank representation in the United States consisting of six primary sections: (1) asset valuation; (2) income and expense items; (3) consolidation rules; (4) off- versus on-balance sheet items; (5) tax considerations; and (6) disclosure rules. These reviews are to be updated whenever any significant changes occur in accounting policies or practices.

Review of the Home Country Financial System

A review of the financial system of each country with bank representation in the United States consists of four primary sections: (1) structure of the financial system; (2) supervision and regulation; (3) treatment of problem or failed institutions; and (4) assessment and conclusions. These reviews are to be updated whenever any of the supervisory agencies obtains significant information regarding the financial system of a particular country.

ROCA Rating System

"ROCA" is the rating system (between 1 and 5) used to assess the condition of U.S. branches and agencies of FBOs within the context of the FBO, of which it is an integral part, and to pinpoint the key areas of concern regarding these branch offices. Measurement criteria for specific ROCA components are presented below:

Risk Management: The extent to which risk management techniques are adequate to control risk exposures and ensure adequate oversight by branch and head office management.

Operational Controls: Internal audit and control procedures should ensure that operations are conducted in accordance with internal guidelines and regulatory policies, and that reports and analyses to senior management are timely and accurate.

Compliance: Demonstrated compliance with all applicable state and federal laws and regulations, including reporting and special supervisory requirements.

Asset Quality: As a branch is not a separately capitalized entity, consideration of its ability to meet its obligations on a stand-alone basis is most important in cases when support from the FBO is questionable. In these instances, asset quality is evaluated based on the level and composition of classified exposures and nonaccrual and reduced rate assets.

Composite Rating: The composite rating indicates whether, in the aggregate, the operations of the branch may present supervisory concerns and the extent of any concerns. While the individual ROCA components are taken into consideration in arriving at this overall rating, the composite measure is not merely an arithmetic average of the individual components.

Strength-of-Support Assessment ("SOSA")

The FBO's two-component strength-of-support assessment ("SOSA") is developed annually through analysis of available information on the financial and operational condition of the FBO within the context of the home country accounting and financial system reviews; the demonstrated abilities of the home country in dealing with banking problems; and the degree of transfer risk associated with the FBO's home country and any other countries in which it has major operations. The analysis is to be updated during the course of the year if information becomes available that is significant enough to change the SOSA of the FBO.

The first component of the SOSA addresses whether any factors relating to the ability of the FBO to meet its U.S. obligations warrant special monitoring of the FBO's U.S. operations. This component is a reflection of the overall financial viability of the FBO as well as several external factors such as the degree of supervision the FBO receives from its home country supervisor. This component is based on a scale of "A" through "E" with "A" representing the lowest level of supervisory concern and "E" representing the highest.

The second component of the SOSA, to be utilized on an as-needed basis, identifies whether there are any factors that raise questions about the ability of the FBO to maintain adequate internal controls and compliance procedures at its U.S. offices, irrespective of the overall financial condition of the FBO. If any such control risks are apparent, an asterisk is placed next to the letter component of the strength-of-support assessment.

Summary of Condition and Assignment of a Combined Rating

An annual "Summary of Condition" is prepared for all FBOs with U.S. vehicles supervised by more than one agency, providing an overview of the condition of the FBO's

combined U.S. operations and leading to the assignment of a single-component "Combined Rating" between 1 and 5 for the combined U.S. operations.

This evaluation should include an assessment of all risk factors, including all elements of the ROCA rating system; the quality of risk management oversight employed by all levels of management in the FBO's U.S. operations; and the examination results for all FBOs vehicles performed during the year.

Assessment of the combined rating should be taken into account in reaching decisions regarding the scope and frequency of future examinations and appropriate supervisory measures. It should also provide a basis for the more efficient utilization of supervisory resources (e.g. recognizing, where appropriate, a low or high risk of supervisory concern for the combined U.S. operations of an FBO.)

This Summary of Condition product should not be treated as an examination report and, as such, should not contain examination specific data. Instead, the Summary of Condition should take the form of a letter to the appropriate head office management and highlight those areas of systemic weaknesses and overall strengths in the FBO's U.S. operations.

U.S. Banking Office of a Foreign Banking Organization ("FBO")

A U.S. banking office represents an operation by a foreign bank within the U.S. whose presence would qualify the bank as an FBO, including a U.S. branch or agency; an Edge Act or agreement corporation; a commercial lending company subsidiary; or control of a bank within the United States. Operation of representative office and/or nonbank subsidiary within the U.S. would not meet the definition of a U.S. banking office, as these operations alone do not qualify the foreign bank as an FBO.